VIRGINIA:

In the Supreme Court of Virginia held at the Supreme Court Building in the City of Richmond on Thursday the 14th day of November, 2019.

Present: Chief Justice Lemons, Justice Mims, Justice Powell, Justice Kelsey, Justice McCullough, Justice Chafin, and Senior Justice Koontz

S. Wallace Edwards and Sons, Inc., Appellant,

against Record No. 180902
Circuit Court No. 16-025

Selective Way Insurance Company, et al., Appellees.

Upon an appeal from a judgment rendered by the Circuit Court of Surry County.

Upon consideration of the record, briefs, and argument of counsel, the Court is of opinion that there is reversible error in the judgment of the circuit court.

On May 26, 2016, S. Wallace Edwards and Sons, Inc. ("Edwards") filed a 13-count complaint against Selective Way Insurance Company ("Selective"), MRC 2011, Inc. d/b/a Manry-Rawls Corporation and Manry-Rawls, LLC (collectively "Manry"), and Middle Peninsula Insurance Agency, Incorporated, d/b/a Middle Peninsula Insurance & Financial Services ("MidPen") alleging breach of contract and various tort claims arising from the inadequacy of insurance coverage on its business. Relevant to this appeal, Edwards alleged a claim of constructive fraud against Selective (Count VII), breach of an oral contract against MidPen (Count VIII), and fraud and constructive fraud against Manry and Selective (Counts XII and XIII).

Manry and Selective demurred, claiming that Counts VII, XII and XIII were tort claims based on breaches of alleged contractual duties and were therefore barred under the economic loss doctrine. In response, Edwards insisted that the tort claims were independent from any alleged contractual duties. It specifically asserted that the alleged fraud preceded the contract and induced it to enter into an agreement with Manry and Selective. After considering the matter, the circuit court sustained the demurrer on Counts VII, XII and XIII. In a letter opinion,

the circuit court determined that the claims were contractual in nature and "governed by the Source of Duty Rule as an extension of the Economic Loss Doctrine." The circuit court further denied Edwards leave to amend its claim.

On August 24, 2017, MidPen filed its answer to Edwards' complaint. With regard to Edwards' allegation that the parties entered into an oral contract in 2015, MidPen admitted "that it had a contractual relationship with [Edwards] to provide certain insurance services" and "that in 2015 [MidPen] agreed to provide service to [Edwards] with respect to the renewal of its business insurance coverage, subject to any changes [Edwards] requested." MidPen also served interrogatories on Edwards. One of the interrogatories requested that Edwards:

> Identify with particularity and describe in detail all facts that support or relate to your allegations in Count VIII of the Complaint that Edwards and Middle Peninsula entered into an oral contract. Your answer to this interrogatory should include (a) the names of the individuals from both Edwards and Middle Peninsula who agreed to the terms of any such oral contract and any witnesses having knowledge of any such contract; (b) the means of the communication (i.e., whether in person, by telephone, or other means), (c) the exact date or dates the oral contract was negotiated and agreed to, (d) the exact and complete terms of the oral contract, (e) the exact words that were said by each individual in negotiating, agreeing to and entering into the oral contract, and (f) whether the oral contract was the first oral contract between the parties or was a continuation or repetition of a prior agreement between the parties.

In response, Edwards provided details about the entire contractual history between Edwards and MidPen. Notably, Edwards' response focused primarily on the events that precipitated the initial 2012 contract. After establishing the details about the 2012 contract, Edwards' answer to the interrogatory briefly mentioned the fact that, on February 5, 2015, Edwards contacted MidPen asking whether it needed additional coverage for cold storage. In response, MidPen recommended adding "spoilage coverage." Also, Edwards claimed that,

> in the time period leading up to the renewal or re-marketing of Edwards' insurance commercial insurance portfolio in the spring of 2015, MidPen did not advise Edwards that its insurance policies with Selective were deficient in any way. Nor did MidPen make any recommendations that Edwards change its coverage levels.

MidPen subsequently filed a motion for summary judgment claiming that Edwards had abandoned its breach of contract claim with regard to the 2015 contract due to the repeated

references to the 2012 contract in the interrogatories. MidPen further asserted that it was futile to allow Edwards to amend its complaint to bring a breach of contract claim on the 2012 contract as such an action was time barred. As an alternative to summary judgment, MidPen filed a plea in bar that was expressly contingent on the circuit court electing to grant Edwards leave to amend its complaint to allege that the parties had entered into an oral contract in 2012. In response, Edwards noted that it had specifically pled that the parties entered into an oral contract in 2015 and MidPen had admitted this fact.

After considering the matter, the circuit court granted MidPen's plea in bar, explaining:

> [Edwards] assert[s], and it is uncontradicted, that the parties first entered into an agreement to provide insurance services in 2012. While [Edwards] seek[s] to rest [its] claim on the 2015-16 renewal of that agreement, asserting it to be a new and divisible contractual undertaking, they allege that the policies were ineffective in their coverage from the very inception of the business relationship in 2012. Edwards asserts that MidPen delivered the insurance policy in 2012, and that the policies were ineffective from that time forward. The Court finds that the controlling time for determining when the alleged breach of contract occurred is 2012.
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> A careful review of the facts of this case and the application of the applicable law convinces the Court that the Statute of Limitations began to run in 2012, the time the initial allegedly inadequate policy was placed by MidPen with Edwards, notwithstanding subsequent renewals of the same policy, and regardless of when Edwards suffered a compensable loss under the policy. The Plaintiff's injuries flow directly from the 2012 failure to adequately insure when the first policy was placed, and it is impossible to divorce Plaintiff's 2015 injuries from the 2012 breach. Accordingly, 2012 serves as the date from which to determine the Statute of Limitations.

This appeal ensued.

A. Demurrer

Edwards first argues that the circuit court erred in dismissing its fraud in the inducement of a contract claims by applying the source of duty rule. Under the source of duty rule, if the duty that was allegedly violated arises out of a contract, the action sounds in contract; if the duty arises irrespective of a contract, i.e., at common law, the action sounds in tort. *Richmond Metro. Auth. v. McDevitt Street Bovis, Inc.*, 256 Va. 553, 558 (1998). The source of duty rule, however,

has no application to a claim of fraudulent inducement of a contract. Notably, the focus of such a claim is the purportedly fraudulent actions that were perpetrated *before* the contract existed. *See Tingler v. Graystone Homes, Inc.*, ___ Va. ___, ___ n.11 (2019); *Abi-Najm v. Concord Condominium, LLC*, 280 Va. 350, 363 (2010).[1] Indeed, by bringing a fraud in the inducement to contract claim, a party is essentially seeking to have the contract vitiated due to the allegedly fraudulent act(s) that induced them to enter into that contract. *See Wilson v. Carpenter*, 91 Va. 183, 187 (1895) (recognizing that fraudulent inducement of a contract "is always ground for rescission of the contract"). Thus, as the Court recognized in *Abi-Najm*, "it cannot logically follow that the duty [the defendant] allegedly breached was one that finds its source in the [c]ontracts." 280 Va. at 363. Accordingly, the circuit court erred in relying on the source of duty rule to sustain the demurrer.[2]

To survive a demurrer, Edwards was required to plead that Manry and Selective made false statements of material fact for the purpose of procuring the contract, that it relied on those statements and was induced by the statements to enter into the contract. *Max Meadows Land & Imp. Co. v. Brady*, 92 Va. 71 (1895). With regard to both Selective and Manry, Edwards specifically alleged that they had "falsely represented the material fact of the amount of property and business income necessary for Edwards." Edwards further asserted that Selective and Manry intended for it to "rely on these false representations," which it did, to its detriment. Therefore,

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[1] Manry and Selective rely heavily on the Court's holding in *Filak v. George*, 267 Va. 612 (2004). However, the fraud alleged in *Filak* is different from the fraud in the inducement to contract alleged by Edwards. Notably, the fraud claim at issue in *Filak* involved the breach of a duty that "arose solely from the parties' alleged oral contract." *Id.* at 619. Although the parties in the present case had an existing contractual relationship, the fraud alleged by Edwards was in the context of misrepresentations made to induce it to enter into a new, separate contract. In other words, the alleged fraud did not arise from the parties' existing contract, it arose in the formation of the second contract. Accordingly, given the posture of the present case, any reliance on *Filak* in the present case is misplaced with regard to the allegations raised by Edwards in its complaint.

[2] The Court's review of this issue is confined to the specific rationale offered by the circuit court in sustaining the demurrer (i.e., that the source of duty rule bars Edwards' claims). Accordingly, the Court makes no ruling with regard to the alternative bases for sustaining the demurrer as to Counts VII, XII and XIII that Manry and Selective raise in their briefs. These matters remain open for consideration by the circuit court, should the parties choose to raise them.

Edwards' complaint contains sufficient allegations regarding each required element of its claim.[3] Accordingly, the circuit court erred in sustaining the demurrer as to Counts VII, XII and XIII.

B. Plea in Bar

Edwards next argues that the circuit court erred in granting MidPen's plea in bar on its breach of oral contract claim.[4] Edwards points out that, in its complaint, it specifically alleged that the oral contract was formed in 2015 between Edwards and MidPen, whereby MidPen would procure insurance for Edwards for a twelve-month period spanning 2015-2016. It also notes that MidPen admitted in its answer that it entered into an agreement with Edwards in 2015.

In granting the plea in bar, the circuit court determined that Edwards' cause of action arose with the 2012 contract, which established the coverage deficiencies that Edwards takes issue with in the present action. Noting that the 2015 contract was a renewal of the 2012 contract, the trial court ruled that, because the same deficiencies existed in the policies procured by MidPen under the 2012 and the 2015 contracts, "it is impossible to divorce [Edwards's] 2015 injuries from the 2012 breach." Stated differently, the circuit court ruled that the statute of limitations began to run when MidPen delivered the first deficient policy to Edwards in 2012. The circuit court's focus on the 2012 policy was error.[5]

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[3] To the extent that the precise nature of the claims asserted by Edwards was unclear, the circuit court should have given it the opportunity to clarify by granting leave to amend its complaint. *See* Rule 1:8 ("Leave to amend shall be liberally granted in furtherance of the ends of justice.").

[4] It should be noted that the circuit court granted the plea in bar on a basis not sought by MidPen. Notably, MidPen's plea in bar was expressly contingent on the circuit court granting Edwards leave to amend its complaint to base its breach of contract claim on the 2012 contract. Edwards never moved for leave to amend its complaint to make the 2012 contract with MidPen the basis of its complaint, nor was such leave ever granted by the circuit court and therefore the circuit court had no basis for granting MidPen's plea in bar. Edwards, however, did not raise any objection to the circuit court's *sua sponte* decision to grant a plea in bar on this basis. Accordingly, the Court will not consider this as a basis for reversing the decision of the circuit court. *See* Rule 5:25.

[5] In reaching its conclusion the circuit court relied on two cases. The first case, *Thurston v. Mike McDonald Agency, Inc.*, Docket No. CL09-6496 (Virginia Beach Cir. Ct., July 12, 2011), is wholly inapposite to the present case. *Thurston* involved a single oral contract between an insurance broker and the insured that occurred approximately four and a half years before the insured discovered that the policy at issue was deficient. The present case involves allegations of

In its complaint, Edwards specifically alleged that, in 2015, the parties formed a contract for the limited purpose of renewing Edwards' insurance policy with Selective for 2015-16. The 2015 contract was admittedly similar to the previous contracts between the parties, as demonstrated by the repeated references to the 2012 contract in Edwards' first set of interrogatories. However, the complaint specifically alleges that the 2015 contract was distinct from the previous contracts between the parties as the 2015 contract was the only contract between the parties whereby Edwards sought, and MidPen agreed to procure, insurance coverage for 2015-16. Notably, the Court has explicitly held that

> [T]he services performed by an insurance broker and an insurance agency on behalf of an insured ordinarily entail separate, independent acts involving an initial sale, a policy renewal, a policy change, or the processing of a claim . . . . Further, since these actions do not, by their nature, require continuing work by the broker or the insurance agency, they cannot be characterized as continuing services relating to a particular undertaking.

Harris v. K & K Ins. Agency, Inc., 249 Va. 157, 162 (1995).

Where parties have a continuous contractual relationship made up of separate and distinct contracts dealing with the same subject matter, it does not change the fact that the specific date the parties entered into the contract at issue governs the running of the statute of limitations, not the date that the relationship began. *Id.* Therefore, if, as Edwards alleged in its complaint, the parties had an ongoing contractual relationship whereby each year MidPen agreed to provide its

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multiple contracts to procure a new and adequate insurance policy each year. Therefore, the present case is readily distinguishable from *Thurston*.

Further, it appears that the circuit court misinterpreted the second case, *Cunningham Bros. Used Auto Parts v. Zurich Am. Ins. Co.*, No. 6:17-CV-00051 (W.D. Va. Oct. 19, 2017). In *Cunningham Bros.*, the district court ruled that the statute of limitations began to run against the insurance broker on the date that the policy was renewed and not the date that the loss occurred. *Id.* at *4. The district court explained that this was because once the policy was procured, the insurance broker had no further obligation to the insured. *Id.* (citing *Harris v. K & K Ins. Agency, Inc.*, 249 Va. 157, 161 (1995)). Implicit in the district court's ruling was the notion that, had the insured filed its action within three years of the policy renewal, the statute of limitations bar would not apply. *Id.* Such a ruling is directly on point with the argument raised by Edwards. The only distinction between the present case and *Cunningham Bros.* is the fact that, unlike the insured in *Cunningham Bros.*, Edwards filed its claim within three years of the date on which its policy was renewed. Thus, under *Cunningham Bros.*, Edwards should have been permitted to proceed with its claim.

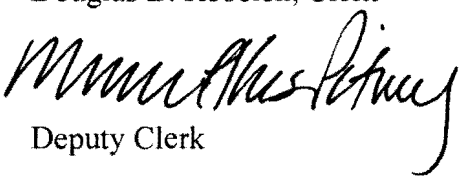
services to broker the sale of an insurance policy to replace the one that would soon expire, under *Harris*, each contract would be considered a separate and distinct contract from the one before it. *Id.* Thus, based on Edwards' allegations that the parties had a contractual relationship made up of separate and distinct contracts and that it was the 2015 contract that was breached, the circuit court's focus on the deficiencies in the 2012 contract was misplaced. Accordingly, the circuit court's decision to grant the plea in bar is reversed and the matter is remanded for further proceedings.

This order shall be certified to the Circuit Court of Surry County.

A Copy,

Teste:

Douglas B. Robelen, Clerk

By: 

Deputy Clerk